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Nonprofits at the Crossroad: Embrace Change, Learn to Compete

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The tide of continuous change brought on by the impact of the globally centric marketplace is transforming the way we conduct just about every aspect of our lives today - whether it be on a national scale or a regional-local footprint. The shift that has been taking place is impacting the fundamental way we conduct ourselves - in our relationships, our commerce, our civic engagement, the formation and implementation of our public policy, and the manner in which we define and exercise our belief systems.

As both a national and global society, we have become more interdependent on one hand and more competitive with each other on another. While we depend upon mutual gains for our collective needs, we are more competitive than ever for our own individual piece of the action, stopping at nothing to seize what we perceive as our own entitlement, no matter its cost to others and the common whole.

This paradox is vividly illustrated in the current debate over the role of faith in our public policy: We preach inclusion for everyone within a concept of one people under a "God" or "greater good", yet compete with each other for the preeminence of our own faith choices as if one practice or tradition is more credible, more historically defensible, and most apropos to be the valid policy approach for what ails us all.

Competition is now the driving force

Underlying this fundamental shift in the way we conduct ourselves is the notion of competition. Competition is now essential to acquiring what we need on both a personal and communal basis. We compete in the way we relate to each other - vying for attention and engagement, loyalty and trust, and physical needs. We compete in our civic engagement - striving for numbers of supporters, empathy for our point of view, the dollars to advance our special interest, and the influence to wield power. We compete in the workplace - playing politics to suit our personal agenda, and redefining the historic norms of personal relationships to get ahead. And we compete for our place in a preferred lifestyle - seeking out the best neighborhood, demanding schools pay attention to our 'special' kids, and networking into membership at the most prestigious country club.

The notion of competition in and of itself is a necessary phenomenon in a world that is becoming increasingly influenced by forces beyond our immediate control. It is part of the equation that holds a growing interconnected global community in check and balance; the most advanced nations push the envelope of discovery and application that the more primitive cultures later assimilate in their evolution to a higher standard.

Competition was once perceived by many in the nonprofit realm as an evil necessity of the corporate world. It is now the norm for serving the needy and protecting the interests of society's vulnerable populations. Nonprofits no longer can bask in their status, privilege, and deference. There is little left to go around. Stock market declines have diminished their financial cushion while federal spending cuts have increased demand for their services. Donations and funding are harder to come by amidst a growing federal deficit, tight state budgets, and recovering corporate earnings. The big portfolio losses experienced by many foundations have forced cutbacks to organizations in the nonprofit food chain that depend on them. The once impermeable store of public trust has ruptured from media disclosures of excessive administrative costs, trustee fees, and executive compensation packages, to say nothing of misappropriated donations, accounting fraud, and management incompetence. No charitable or philanthropic foundation, professional or trade association, religious institution, advocacy organization, or social service agency is immune to the new norm of hyper competition.

Is it any wonder that the very entities whose historic charge is to protect society's most vulnerable - those caught in the fallout of our hyper-competitive individualism - would now be threatened by the same forces? Nonprofits as we have known them, and as they have understood themselves, are dying. However, it is not competition that is the culprit of their failed ambitions, but the nonprofit's unwillingness to properly and adequately compete.

Resolving the dilemma of how to more successfully compete is too complex and multi-dimensional to address in the context of this overview, so we will present a snapshot of some key issues that suggest the answer lies significantly, but not totally, in the performance (behavior) of nonprofit organizations and those charged with leading them.

Non-profits as competitive businesses

Despite the inherent tendency of many nonprofits to reinforce a legacy mentality that everything they do must be a struggle, as if such behavior is the only reliable demonstration of how needy their cause is (which it is not), some nonprofits, fortunate to have futuristic leadership, are venturing into the brave new world of commercial or "for-profit" extensions.

Such operations, often formed as subsidiaries or within a public-private partnership, collaboration or network association, create new avenues for solutions that the parent organization may not be in a position to implement singularly on its own. This emerging, inventive operation model has, for example, enabled organizations to build coalitions or acquire consensus for mission imperatives that normally would be difficult for any number of reasons: a turn in the political current, the need to work around barriers created by new regulatory restrictions, or attempts at closing funding gaps and budget deficits with sources previously tapped out by the conflicting agendas or marketplace dominance of competitors.

There is an abundance of viable solutions and models of best practices in the commercial sector to lead underperforming nonprofits to the promise land of competitive sustainability. The academic community and the federal government are particularly experienced at such knowledge transfer initiatives. The opportunity for nonprofits is quite uncomplicated if the right strategic leadership is in place to shepherd the organization in confident and responsible risk-taking.

"Companies and organizations that strive for social change can show us the possibilities of running a business-like nonprofit, and a nonprofit-like business. And the marriage of the two ideas is our future," declares Robert Egger, president and founder of the DC Central Kitchen in Washington.[1]

Nonprofits can partner for licensing agreements or establish service, manufacturing, or consulting businesses by using assets such as the organization's brand, proprietary intelligence, distribution systems, and real estate. By abandoning outdated operational norms, they can transform themselves into the very creators of the wealth they need for mission critical operations, rather than simply redistributing another source's money.

"They must find ways to combine business success with social impact while overcoming internal concerns that a commercial operation will distract the organization from its core mission or compromise its values," notes Heinz-Peter Elstrodt, Anamaria Schindler, and Andréa C. Waslander in their article "Helping Nonprofits Do Business"[2] for the McKinsey Quarterly.

Elstrodt, Schindler, and Waslander point to the growing participation of nonprofits in business plan competitions, which they deem to be a powerful way to help turn ideas into sustainable commercial ventures. Elevated to a 'varsity sport' by high-flying technology start-ups and early stage ventures seeking angel funding during the 90's boom, business plan competitions are part of a new wave of ideas coming from the strategic thinkers who are not settling for the old school assumptions of traditional nonprofit models.

Gaining exposure in such a competitive forum can significantly enhance recognition for the criticality of an organization's mission, especially amidst today's noisy, over-crowded message marketplace. It can also identify compatible suitors, thereby raising the probability for funding, partnerships and other key collaborations. However, as the authors emphasize, it requires embracing change and developing the will to move forward into less chartered territory:

"Business ventures, once an alien concept in a sector that relied wholly on grants and donations, are now seen as a supplementary funding tool or even as a way to promote a cause directly - for example, by providing training and employment to beneficiaries of social programs."

Many nonprofits lack the business acumen internally to execute such a project, or to even accurately assess which alternative ventures pose workable solutions outside of their traditional operating arena. Nonprofits that can afford it bring external consultants in to make the seemingly impossible more likely. But there are no guarantees that an idea can be translated into a commercial success. All the sages in the world can only go so far without courageous leadership at the helm that understands and embraces calculated, strategic risk as a pathway to greater success. Elstrodt, Schindler, and Waslander add that nonprofits need to "understand the economic realities of their projects and to foresee possible conflicts with the core mission."

While the knowledge and tools at the disposal of commercial entrepreneurs varies widely, most well trained business strategists understand the nuances of good planning, with its focus on process, structure, and logic. In contrast, nonprofit entrepreneurs - of which there are few and who appear to the industry masses as jolly green monsters - have more dynamic, diverse backgrounds but are frequently poor strategic planners, are unfamiliar with business terminology and concepts, and skeptical of management tools.

Traditional nonprofit leaders have tended to frown on ‘market’ competitiveness and the imperatives of branding, promotion over advocacy, and marketing techniques as a means for securing constituent loyalty. However, if they are to advance a 21st century management model for sustainability, they must learn to embrace the difference between positive competitiveness, represented by high-quality products and services, and the negative notion of nonprofits competing against one another. They need to view profitability - as it can be uniquely defined in the not-for-profit context - as a meaningful value critical to advancing their mission or cause.

Eating your own: Stagnant leadership and legacy culture

No award-winning business plan or futuristic leadership team will stand a chance in executing the transformational change critical for sustainability if it is not accompanied by a (likely) Herculean effort at also transforming legacy culture. For it is this factor alone - the historic, inherited organization mindset - that is the greatest barrier to transcending the tired and failing norms of the past.

When business gurus and other analyst types examine the unique challenges of nonprofits and why, in the changed 21st century marketplace, the failure rate of nonprofits is escalating - they point to an entrenched set of behaviors germane to the culture and the industry ‘elite’.

The most obvious indicator that such behavior is flourishing in an organization is the mere longevity of individuals in senior leadership posts, a phenomenon particularly acute in associations and philanthropic or charitable foundations. Here you will find individuals who have held the same top job for a decade or more, and in many instances a quarter of a century. Many of these individuals rose through the ranks of the organization over years to arrive at the top post with a background that would not qualify them for the job if a search for their replacement were conducted today. They have persevered by sheer endurance and length of service, and while they no doubt possess qualities that have contributed to the organization’s success, many are survivors of management failures and crises that in earlier, less scrutinizing times were more easily endured.

Trouble is, the guerilla survival instinct that enables a senior executive to remain in a top post over a generation permeates the organization’s DNA in order to foster the structures that support the entrenched leadership. Things bear down, innovation is elusive, risk becomes the enemy, and dysfunctional communication becomes an operational norm as the organization adopts its own politically correct behaviors.

Too many of these nonprofit leaders remain stuck in the trenches of daily warfare, failing to implement a management discipline that would impart greater strategic thinking to address mission viability and organization sustainability. Entrenched leadership tends to gravitate to the short-sighted comfort of building programs and raising money - which may be important in the immediate term - but then often neglects the structures and processes for building organization capacity, the foundation of enduring institutions.

Such leadership becomes dangerously imbalanced, focusing on the personal prerogatives of self-perpetuation (preservation) and the privileges of power. As their state of leadership becomes an inherited asset of the organization, the culture reinforces a mentality of entitlement, which leads to the blinding "it's not going to happen to us" worldview.

To be fair, nonprofit leaders have a challenge in making the shift to a more strategic emphasis in their management approach. Internal management structures and processes can seem less rewarding than programs that fulfill an organization's mission, and in an era of accountability and results measurement, substantiating a link to performance is not so easy. Organizations that are operating on a shoestring budget and tight deadlines have fewer resources to devote to fundamentals of good management that will impact long-term capacity.

Some experts are promoting the idea that grassroots agencies and institutions need to negotiate new terms and conditions for their relationship with organized philanthropy - the 'parent' foundations that allocate funds to the food chain that the industry depends on. Such a new structure could resemble the capital market system commercial enterprises operate in, where dollars are awarded in a rational system based on performance criteria.

"When you're doing biz in the nonprofit sector you have to have a split vision - what you do today has to be able to be done with an eye toward changing the future," notes DC Central Kitchen's Robert Egger. "It's not enough to see the future coming - you have to go out today and meet it, confront it, challenge it, change it."[1]

The Spitzer effect and the big hammer of Sarbanes-Oxley

We all are well familiar with the leadership lapses, management incompetencies, and accounting fraud that have been perpetrated upon the investing public by the self-identified Wall Street darlings of the 90's boom. For nonprofits, one needs to look no further than the well-publicized controversies at The Nature Conservancy, the American Red Cross 9-11 Fund, the James Irvine Foundation, and the United Way National Capitol Area to understand what all the fuss is about.

The overriding challenge for nonprofits is restoring public confidence in their ability to make good and wise decisions about the dollars entrusted to their management. And the restoration of trust starts with accountability, which necessitates good governance. The new norm of transparency for corporations, and the hyper scrutiny by their investing stakeholders and the public at large, is bringing greater accountability to nonprofit management, financial performance, and program-mission effectiveness.

The 'campaign' by New York State Attorney General Elliott Spitzer to impose new standards in corporate governance and business practices has received widespread attention (to the delight of his gubernatorial exploratory committee!) just as the teeth of new federal legislation has strengthened his efforts, and those of other state attorneys general.

Already the rigorous requirements imposed by the Sarbanes-Oxley Act are influencing America's 1.8 million nonprofits in principle, if only through marketplace forces right now in lieu of actual regulations.

Board members and their organization's management are being pursued by lawmakers and law enforcement bodies around the country with a variety of allegations, some that closely resemble the accounting shell game attributed to Enron and WorldCom. Last summer, the Senate Finance Committee conducted hearings on nonprofit governance. Agents at the IRS have started contacting some 2,000 charities and other nonprofits as a result of their new Tax Exempt Compensation Enforcement Project, to acquire information on compensation practices and procedures. And at least 13 states are mulling new laws that stretch the regulatory arm of Sarbanes-Oxley into the operational realm of nonprofits.

Many of the top tier nonprofits and philanthropic organizations had a track record for successful self-regulation long before the current law enforcement interventions. But compliance to uniform standards was spotty at best and usually the practice of the wealthiest organizations which - because of their marketplace visibility - had more to lose by not keeping up appearances of transparency and accountability.

Some industries or sectors have tried to impose uniform standards on their own, in anticipation of pushing back on the regulatory climate that has engulfed the corporate realm. In January 2004, the American Society of Association Executives Foundation and the New York Society of Association Executives hosted a National Consensus Conference on Nonprofit Governance, examining voluntarily options to enhance fiduciary practices and accountability to members, donors, grantors, and other stakeholders.

Meanwhile, at the request of the Senate Finance Committee, 25 leaders from the country's major nonprofit organizations, public charities, and private foundations convened this winter to develop sweeping reforms designed to force greater accountability and boost penalties for misuse of donor funds.[3] The leaders recommended that top officers of nonprofits be required to sign off on financial filings; establish and enforce conflict-of-interest policies; and make audits of larger nonprofits routine. They also proposed closer scrutiny of compensation and other benefits to nonprofit officials and trustees, new prohibitions on conflict-of-interest behaviors, and a stipulation that board members at charities demonstrate some financial expertise.

Keeping it all above (the) board

Certainly, fundamental differences in nonprofit boards compared to their commercial counterparts have helped lead us to where we find ourselves today. Nonprofit directors volunteer their time, play an important role in raising funds, and in some cases overpopulate their boards to where meetings resemble conferences rather than deliberative assemblies! They also often answer to a wider range of stakeholders. Those influencers may have multiple agendas mixed with political overtones and lack the commitment to fiscal priorities that are inherent in the commercial realm of shareholder value.

A recent McKinsey survey of executives and directors at 32 of the 100 organizations named as top nonprofit performers by Worth magazine found that only 17 percent of the respondents felt that their boards were as effective as possible. Only 46 percent of the directors surveyed thought that the other directors on their boards could both summarize the mission of the organizations they serve, and present a vision of where those organizations hope to be in five years.[4]

The McKinsey study also found that the most successful boards offer professional expertise, represent the interests of their nonprofits to community leaders, recruit new talent to the organization, and provide the more rigorous management and performance oversight that funders increasingly demand. "These boards get their hands dirty undertaking the tasks they do best while carefully avoiding micromanagement that would demoralize full-time staff members," emphasizes researchers Paul J. Jansen and Andrea R. Kilpatrick.

"Good boards, well aware that they lack the time and resources to tackle all of their responsibilities at once, manage to adapt - perhaps by devoting extra energy to a single task, such as a capital campaign, before moving on to the next challenge."

In all likelihood, the recent deliberations on Capitol Hill and elsewhere are going to result in new regulations for nonprofits. It may begin, as Iowa Senator Charles Grassley of the Senate Finance Committee indicates, with new requirements for foundation payouts to coincide with the Bush Administration's pending proposal for new tax cuts affecting donations to charitable foundations. The rest of the cards in the deck could start falling thereafter. If nonprofits are to successfully push back on new government impositions, they must improve their methods of oversight and accountability by venturing beyond the traditional focus on raising money, selecting the senior leadership, and setting high-level policy. They must abandon the old school inbreeding and recruit more qualified and independent colleagues who will inject greater strategic discipline, measure management performance, and ensure more reliable fiscal integrity.

The costs of not 'doing good'

While some industry insiders or other wishful thinkers with a vested interest in the assumption that "the worst is behind us" strive to move on, it is difficult to predict and even keep track of the boomerang effect scandal creates long after the initial offense is committed, discovered and played out in the courts.

While the impact upon publicly held companies is swift, often brought about by the fallout from shareholders or a backlash by consumers, nonprofits may sometimes coast along oblivious to the simmering implosion waiting to boil over.

In contrast to the best intentions of the dubious quick fixers, the courts are just beginning to get going. Only this winter, after a generation of offenses and years of media accounts, the Rev. Paul Shanley was convicted and sentenced in Massachusetts. In February, Bernie Ebbers finally received his reservation confirmation, although his length of stay is yet to be determined. And Ken Lay is busy talking to 60 Minutes in a desperate campaign to influence the potential jury pool in advance of his trial, knowing that the best he can do is cop a public plea to 'take it easy on me'.

It is the system at large that will bear the price but the effect will be delivered locally. The financial burden will be felt across the spectrum of nonprofit operations. The obvious impact already is that corporations no longer write checks so easily to favored charities, investors no longer rely solely on the word of their most trusted advisors, and consumer loyalty to marquee brand products, services or nonprofits flips at the slightest suspicion of impropriety. The hidden price of the credibility breach will be seen for years to come, playing itself out with increases in liability coverage, due process legalities, expanded governance measures, brand and reputation defense, and new justifications for relevance and viability - all of which will demand a greater share of nonprofit leadership resources.

Still, most nonprofit leaders remain complacent regarding the new risks to their organization's brand or reputation equity, and its direct correlation to funding trends, constituent commitment, and therefore operational stability. It is almost as if "that sort" of bad behavior (what we have witnessed in the corporate world) is a phenomenon that generally comes at the price of doing business, in the business world! Or, it is an aberration that can be attributed to only a few of the larger, multinational nonprofits who became too unwieldy and must now come back to their senses.

You need not look far for evidence to the contrary. Unless you read The Boston Globe regularly, or follow the Catholic Church in New England closely, you may have missed the disturbing trends in the Archdiocese of Boston, ground zero in the priest sex scandal.

A significant number of parishes are in the process of being closed just this year and their assets sold to help defray the burden of the civil settlements. Generations of families are being displaced from their houses of worship in a city where Catholic parishes have served as cornerstones for neighborhood community life.

These families are being forced to attend unfamiliar churches in distant locations, uprooting an institutional connectedness that marked a lifetime of personal history. The Cardinal's Annual Appeal, a chief source of funds for a portfolio of important social outreach initiatives, has seen its donations dip to half of its pre-scandal levels. And just last week, a group of prominent Catholic business leaders and academics announced that they have formed a nonprofit organization aimed at professionalizing the governance and administration of the Church in the U.S. Such a bold move will no doubt further strain the relationship between Catholic Americans and Rome, making the job of governing by the U.S. Bishops all the more difficult, to say nothing of how it will change the local relationship between a pastor, his parish flock, and their elected lay leaders.

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Footnotes:

1. Egger, Robert. Begging for Change, Harper Business, 2004.

2. Elstrodt, Heinz-Peter; Schindler, Anamaria; Waslander, Andréa C. “Helping Nonprofits Do Business” The McKinsey Quarterly, December 2004.

3. Healy, Beth; Rezendes, Michael. “Nonprofits Outline Plans for Reform” The Boston Globe, March 2, 2005.

4. Jansen, Paul J.; Kilpatrick, Andrea R. “The Dynamic Nonprofit Board” The McKinsey Quarterly, 2004, Number 2.

ABOUT THE AUTHOR

Art Stewart is a futurist and consulting strategist who focuses on the political, cultural, economic, and sociological dynamics at the convergence of traditional business, new stakeholder empowerment, and public interest values. He has nearly thirty years of experience across the spectrum of his profession, including nineteen years heading his own independent consulting firm based in Boston, Mass.

As an educator, he is presently teaching the undergraduate edition of a curriculum he developed in corporate and social responsibility at Emerson College, and is a Research Fellow at the Bentley University Center for Business Ethics. Art writes and speaks widely on the 'New Responsibility Paradigm', a strategic analytical framework he developed which focuses on the transformation to greater accountability, transparency, authenticity, competency, and leadership integrity across society.

He has helped disruptive innovators successfully execute their go-to-market strategies, guided bricks and mortar corporate organizations in transitioning their business models, assisted non-profit and cause related institutions in modernizing their competitive capabilities, and supported senior executives in building their public leadership platforms to advance their agendas.

Art earned a mid-career Master's in Policy Management from Georgetown University's Public Policy Institute as well as a postgraduate certificate in *Senior Executive Leadership*, also from Georgetown. He holds an undergraduate degree in Mass Communications from Emerson College and has completed "Dealing with an Angry Public," with the MIT-Harvard Law School Public Disputes and Negotiation Program.

His professional achievements have earned Art inclusion in *Who's Who in America*, *Who's Who in Business & Finance,* and *Who's Who in the Media & Communications*.